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Eastern Europe: Shrinking Market for West European Exports

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An Intelligence Memorandum

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This memorandum was prepared by [redacted]
[redacted] Office of European
Analysis. Comments and queries are welcome and
may be directed to the Chief, East-West Regional
Issues Branch, Eastern Europe Division, EURA, on
[redacted]

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This paper was coordinated with the National
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Eastern Europe:
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Summary

Eastern Europe holds very little promise as a market for West European exports. Severe financial problems are forcing these regimes to slash investment and hard currency imports, resulting in reduced economic growth and stagnating—if not falling—levels of consumption. Most East European countries began to slow the growth of hard currency imports in the late 1970s as debt servicing problems mounted; the collapse of Western bank lending to the region has forced steeper cuts in imports over the past year.

Although Eastern Europe's share of West European exports has fallen since 1975, the region remains a more important market than does the USSR. Of the major West European countries, West Germany has the largest stake in trade with Eastern Europe. Since the financial pressures show no sign of easing and other constraints on economic growth are tightening, East European demand for Western goods will likely continue to slump over the next few years.

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*Information available as of 16 July 1982
has been used in the preparation of this report.*

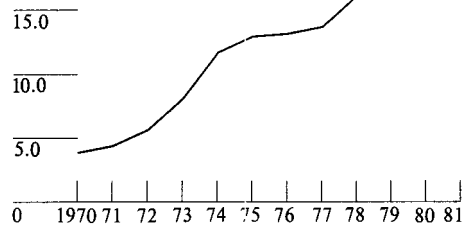
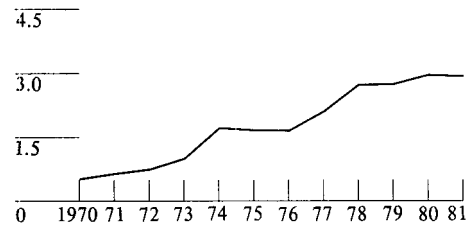
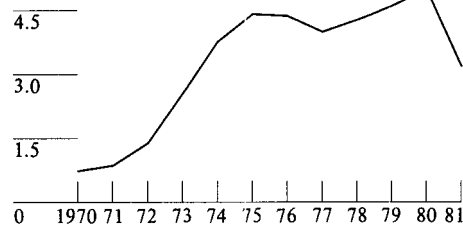
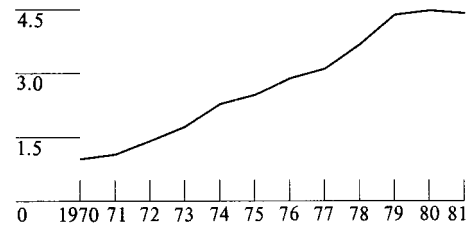
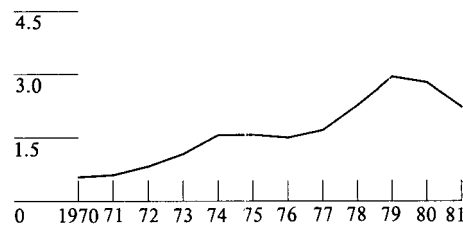
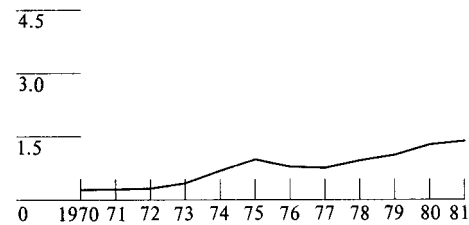
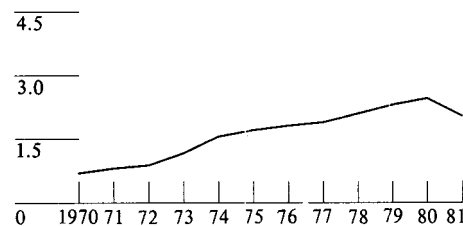
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Figure 1**Imports From Western Europe**

Billion USS

(Note change in scale)

Eastern Europe**Hungary****Poland****East Germany****Romania****Bulgaria****Czechoslovakia**

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Eastern Europe:
Shrinking Market for
West European Exports

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Background

West European exports to Eastern Europe surged during the early-to-mid-1970s as the East Europeans looked to Western goods to modernize their economies and upgrade living standards (figure 1). The rising tide of Western imports, financed largely by credits, supported reasonably rapid rates of economic growth through high levels of investment and rising consumption. The East Europeans had planned to repay credits through improved export performance, but systemic inefficiencies coupled with recession and rising protectionism in the West dashed their hopes for strong growth of hard currency sales. Moreover, the East Europeans were caught on a treadmill of needing more and more credit to cover persistent trade deficits and increasing debt service obligations (table 1).

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As a result, most East European countries began to retrench in the late 1970s and slowed growth largely through steep cuts in investment. Some tried to sustain or slightly increase consumption levels because of concern over popular unrest (table 2). In the cases of Poland and Romania, restraint measures came too late to prevent insolvency and were applied so ineptly that they seriously damaged economic performance. While Bulgaria, Hungary, and Czechoslovakia managed to stabilize their debt positions, the cutbacks—coupled with fundamental economic weaknesses—depressed growth after 1978 to postwar lows. Only East Germany held to a growth policy based on rising hard currency imports and debt. In 1981, Poland's economic collapse, Romania's financial chaos, and mounting concern among Western lenders over creditworthiness of the Council for Mutual Economic Assistance (CEMA) forced all countries except Bulgaria to cut hard currency imports. Purchases from Western Europe declined for the first time in more than 20 years.

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The East European Market

Eastern Europe's share of total West European exports peaked at 3.6 percent in 1975 and fell to 2.2 percent in 1981 (figure 2). By comparison the USSR received 1.9 percent of Western Europe's exports last year while the United States accounted for 6.5 percent. *West Germany* has the largest stake in trade with Eastern Europe among the major West European economies. Its sales to the region fell from 5.6 percent of total exports in 1975 to 3.7 percent in 1981. The shares for *Italy* also declined sharply over this period—from 3.3 percent to 1.6 percent—while the falloff was less severe for *France* and the *United Kingdom*. Because of the slowdown in sales to Eastern Europe in recent years, Western Europe's surplus with the region fell from \$3.7 billion in 1975 to \$700 million last year.

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Table 1Billion US \$
Except Where Noted**Eastern Europe: Balance of Payments
With Non-Communist Countries**

	1971	1975	1979	1980	1981 ^a
Poland					
Trade balance	0.1	-2.7	-1.7	-0.7	-0.4
Current account balance	0.2	-3.2	-2.9	-2.6	-2.2
End-year net debt	1	8	21	24	24
Debt service ratio (percent) ^b	20	30	92	101	193
Romania					
Trade balance	-0.2	-0.1	-1.1	-1.5	0.6
Current account balance	-0.3	-0.3	-1.6	-2.4	-0.4
End-year net debt	1	3	7	9	10
Debt service ratio (percent) ^b	33	23	22	25	32
East Germany					
Trade balance	-0.2	-1.1	-2.0	-1.7	-1.4
Current account balance	-0.3	-1.2	-2.0	-1.7	-1.9
End-year net debt	1	5	10	12	13
Debt service ratio (percent) ^b	18	25	54	55	64
Hungary					
Trade balance	-0.3	-0.7	-0.2	0.3	0.4
Current account balance	-0.3	-1.0	-0.8	-0.4	-0.9
End-year net debt	1	3	6	7	7
Debt service ratio (percent) ^b	15	19	37	30	40
Czechoslovakia					
Trade balance	0	-0.4	-0.4	0	0.3
Current account balance	-0.2	-0.6	-0.5	-0.4	-0.2
End-year net debt	0	1	4	4	4
Debt service ratio (percent) ^b	9	14	22	18	22
Bulgaria					
Trade balance	-0.1	-0.6	0.7	1.0	0.7
Current account balance	0.1	-0.7	0.5	0.9	0.6
End-year net debt	1	3	4	3	2
Debt service ratio (percent) ^b	45	33	38	32	36

^a Preliminary estimates.^b Repayments of medium- and long-term debt plus interest on net debt as a share of exports to non-Communist countries.

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Table 2

Percent

Eastern Europe: Growth in Aggregate Indicators ^a

	1978	1979	1980	1981
Poland				
GNP	3.5	-1.7	-3.9	-6.6
Private consumption	0.5	0.9	-0.5	-0.5
Investment and other outlays	2.8	-8.3	-12.4	-19.6
Romania				
GNP	4.7	3.8	-1.7	1.0
Private consumption	4.9	4.8	2.7	1.0
Investment and other outlays	4.9	2.6	-7.8	1.1
East Germany				
GNP	1.8	2.7	2.4	2.4
Private consumption	2.1	2.1	1.5	1.5
Investment and other outlays	-4.8	-1.4	6.4	4.8
Hungary				
GNP	2.7	0.6	0.5	0.6
Private consumption	3.3	1.3	1.4	2.1
Investment and other outlays	13.7	-14.8	-3.2	-6.2
Czechoslovakia				
GNP	1.7	0.9	1.7	0.1
Private consumption	2.8	-0.1	-0.4	1.0
Investment and other outlays	-3.2	-2.3	3.9	-2.6
Bulgaria				
GNP	2.1	3.6	-2.8	3.0
Private consumption	1.7	1.9	0.8	1.3
Investment and other outlays	-9.6	-1.1	-8.0	-8.9
Eastern Europe				
GNP	2.7	1.0	-0.6	-0.9
Private consumption	2.3	1.6	0.7	0.8
Investment and other outlays	0.4	-4.1	-2.8	-5.5

^a GNP growth is based on Western reconstructions of officially published data in order to conform to generally accepted standards of national income accounting and product valuations according to factor cost. "Investment and other outlays" is a residual value calculated by subtracting from the value of GNP the values of private and government consumption and the export surplus (or adding the import surplus). The residual encompasses gross investment, research and development, defense, and other elements of government consumption.

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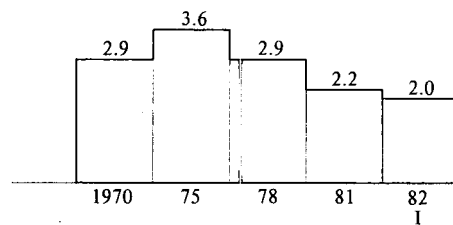
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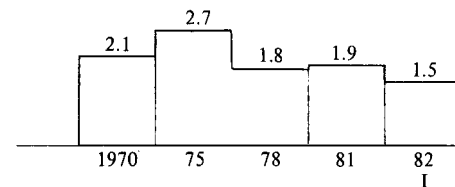
Figure 2
Western Europe: Share of Exports
Going to Eastern Europe

Percent

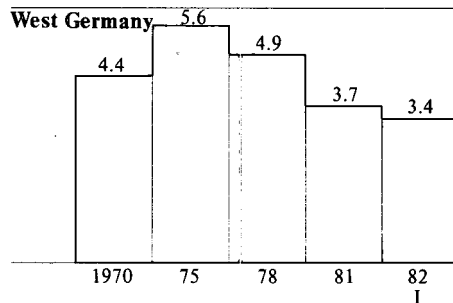
Western Europe



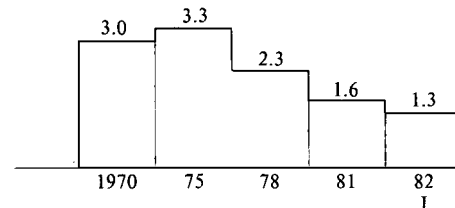
France



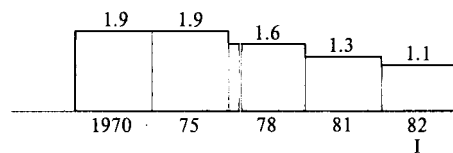
West Germany



Italy



United Kingdom



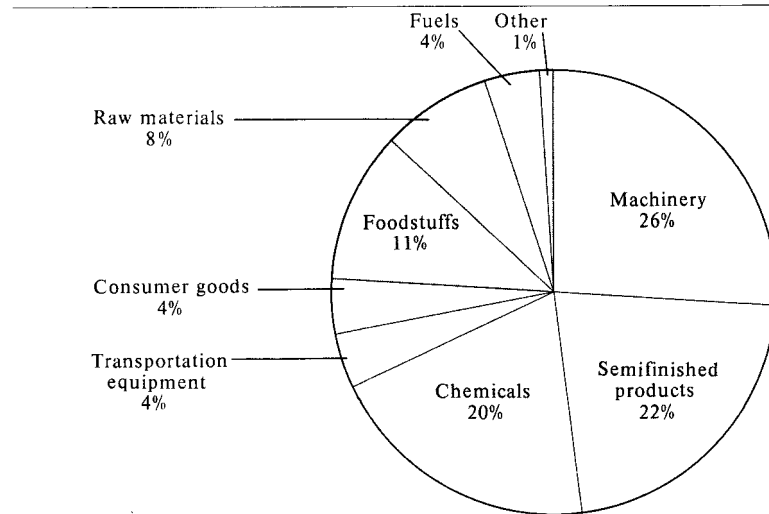
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Sales to *Poland* led both the strong growth of West European exports in the early 1970s and the decline in recent years. Warsaw's spending spree in 1970-75 moved Poland ahead of East Germany as the leading East European importer from Western Europe, and by 1975 the Poles accounted for over one-third of East European purchases. Tightening financial stringencies and the economic slide reduced Poland's share of imports from

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Figure 3**Eastern Europe: Imports From Western Europe**

- ☐ Manufactures
- ☐ Non-manufactures

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Western Europe to under 20 percent by the end of 1981. As a result, *East Germany* has again become the leading purchaser of West European goods, accounting for over one-fourth of imports.

From 1970 to 1978, *Hungary* trailed only *Poland* in the rate of growth of imports from Western Europe. Although Budapest moved to slow import growth after 1978 in order to stabilize its hard currency debt, its share in East European imports has risen steadily and now equals that of *Poland*. *Czechoslovakia*, because of its conservative policy toward debt accumulation, has shown the slowest growth of imports from Western Europe. *Romania*, after following a generally conservative policy toward hard currency imports through the mid-1970s, accelerated purchases of West European goods in the late 1970s until financial problems forced a cutback over the past two years. After a sharp upswing in hard currency imports in 1974-75 led to a dangerous increase in its debt service costs, *Bulgaria*

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Table 3

Percent

**Eastern Europe: Composition of Imports
From Western Europe in 1980 ^a**

	Eastern Europe	Poland	East Germany	Hungary	Romania	Czecho- slovakia	Bulgaria
Manufactured goods	76	73	71	85	75	76	85
Of which:							
Machinery	26	25	22	26	26	33	26
Including:							
Machine tools	3	3	3	1	5	3	2
Electrical machinery	5	4	4	5	5	5	5
Chemicals	20	17	18	24	16	24	19
Including:							
Plastics	4	5	2	6	2	2	4
Semifinished goods	22	20	22	27	27	13	32
Including:							
Steel	7	7	6	3	13	2	16
Textiles	5	4	5	10	3	3	3
Transportation equipment	4	8	3	3	2	2	4
Consumer goods	4	2	4	5	3	5	4
Foodstuffs	11	18	13	5	9	9	5
Including:							
Grain	5	12	3	2	2	3	0
Raw materials	8	7	6	8	8	11	6
Fuels	4	1	10	1	7	1	3
Other	1	1	0	1	1	3	1
Total	100	100	100	100	100	100	100

^a Because of rounding, components may not add to totals shown.

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tightened up on purchases from Western Europe. A stronger financial position has permitted Sofia to increase imports in recent years.

More than three-fourths of Western Europe's shipments to Eastern Europe are manufactured goods: primarily machinery, semifinished products (mainly steel and textiles), and chemicals (figure 3). In the early 1970s, manufactured goods dominated exports even more; as the East Europeans began cutting back on investment, however, foodstuffs and consumer goods grew in importance and now account for 15 percent of West European shipments versus 9 percent in 1975 (table 3). Exports of steel, plastics and other chemicals, machine tools, and textiles to Eastern Europe accounted for 10 to 15 percent of sales outside of Western Europe in 1980 (table 4). Similarly, Eastern Europe has consistently received some 20 percent of Western Europe's exports of grain in recent years.

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Table 4

Percent

**Western Europe: Share of Major Exports
Going to Eastern Europe in 1980 ^a**

	Western Europe	West Germany	United Kingdom	France	Italy
Manufactured goods	7	4	1	2	2
Chemicals	12	6	2	3	4
Plastics	13	4	3	2	3
Semifinished products	9	5	1	2	2
Steel	13	6	1	2	3
Textiles	12	6	2	2	3
Machinery	7	4	1	3	3
Machine tools	11	5	3	15	8
Electrical machinery	3	3	1	2	2
Transportation equipment	2	1	1	1	1
Consumer goods	4	2	1	1	0
Foodstuffs	9	6	3	2	2
Grain	20	9	22	7	2

^a Shares for Western Europe exclude intra-West European sales.
Shares for the individual countries include sales to other West
European countries.

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Current Trends

Last year's falloff in imports is accelerating. East European purchases from Western Europe are down 10 percent in the first quarter of 1982 compared with the same period a year ago. Poland and Romania have reduced imports by nearly 30 percent while the cutbacks for Czechoslovakia, East Germany, and Bulgaria amount to roughly 5 percent. Hungary, however, has stepped up imports by more than 15 percent [redacted] 25X1

The decline in hard currency imports will almost certainly continue through 1982 and into next year since Eastern Europe's financial crisis shows few signs of easing: 25X1

- Poland's debt rescheduling problems appear even more formidable this year than last. Western governments have suspended talks on debt relief for 1982 and are unwilling to extend further credits. [redacted]

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[redacted] Even with rescheduling terms similar to last year, we estimate that Warsaw will still have a financial gap of \$2 billion to cover, with little prospect for obtaining the imports needed to support economic recovery. 25X1

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- Western governments have announced that preliminary agreement was reached in early July on rescheduling 80 percent of Romania's overdue 1981 payments and 1982 debt service due on its official debt. Final agreement is expected by the end of July. Bucharest has proposed similar terms to Western banks for rescheduling its private credits and has requested a response by the end of July.

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[REDACTED]

Romania's major problem is to restore the confidence of creditors by demonstrating its ability to manage its external finances more wisely and to take overdue steps to deal with domestic economic problems.

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[REDACTED]

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- Although East Germany so far has managed to cover its financing needs through drawdowns of unused credit lines and short-term trade credits, [REDACTED] sharply rising debt repayments could provoke a cash-flow crisis by late 1982 or early 1983.

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[REDACTED]

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Trade With the USSR

In addition to the cutbacks in Western credits, Eastern Europe's growth prospects are dimmed by slowing deliveries of energy and raw materials from the USSR. Moscow has already reduced 1982 concessionary oil deliveries to Czechoslovakia, East Germany, and Hungary by 10 percent,

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[REDACTED]

[REDACTED] The reductions in Soviet oil deliveries will have to be offset by stricter conservation and cutbacks in transportation and industrial activity because of inability to pay for purchases on the world market. Moreover, an expected deterioration in Eastern Europe's terms of trade with the USSR and growing Soviet impatience over Eastern Europe's trade deficits will force these countries to divert more goods to the Soviet market. We believe that the USSR will demand more imports of goods otherwise saleable in the West, further reducing Eastern Europe's hard currency import capacity.

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Adjustment Measures

Tightening external constraints leave the East European regimes little choice but to impose more severe austerity programs. More cuts in investment and in imports of Western capital goods seem likely, but the scope for such cuts is increasingly limited if the East Europeans are to improve the efficiency and export competitiveness of their economies. Thus, more of the adjustment burden will probably fall on consumers, but these regimes will be on guard for signs of popular unrest:

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◦ [redacted] [redacted]
In order to free up goods for export, the Hungarian Government will cut domestic purchasing power through price increases for meat and other food items as well as tighter domestic credit.

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◦ [redacted] Prague plans reductions in hard currency imports for at least the next two years to counter the Western credit freeze.

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◦ East German party chief Honecker has announced reductions in grain imports [redacted]

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Prospects

Because of continuing debt servicing problems at least through the mid-1980s, the East Europeans will be unable to increase hard currency imports unless they can boost their exports. Although an economic rebound in major Western markets would strengthen Eastern Europe's sales, export growth undoubtedly will be slow. Eastern Europe's major hard currency exports—chemicals, metals, textiles, and clothing—confront hardening protectionist sentiment as well as stiff competition from developing countries. The East Europeans already have had to negotiate export restraint agreements with the European Community for most of these commodities while the EC's Common Agricultural Policy discriminates against their sales of foodstuffs. Only Romania, which has negotiated a bilateral trade pact with the EC, and East Germany, which enjoys valuable advantages through its special trade relationship with West Germany, have somewhat freer access to West European markets. [redacted]

Several of these regimes have taken some minor steps to improve export performance, but only Hungary is prepared to institute the fundamental reforms needed to improve competitiveness. Without an improvement in

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borrowing conditions or in export performance, the East Europeans will try to secure imports of needed Western goods by pressing for more counter-trade deals. This option has limited prospect for success due to continued resistance on the part of West European trading partners to the East European goods offered in these barter arrangements.

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